

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF THE LEVEE ROAD WATER)	
ASSOCIATION, INC., FOR (1) A CERTIFICATE)	
OF PUBLIC CONVENIENCE AND NECESSITY TO)	
EXPAND ITS DISTRIBUTION SYSTEM, (2) AP-)	CASE NO. 9410
PROVAL OF THE PROPOSED PLAN OF FINANCING)	
OF SAID PROJECT, AND (3) APPROVAL OF THE)	
PROPOSED WATER RATES)	

O R D E R

On August 14, 1985, Levee Road Water Association ("Levee Road") filed its Application and Motion to reopen Case No. 9212, wherein it had sought Commission approval to increase its water service rates, authorization to construct a \$366,300 waterworks improvement project, and approval of its financing for the proposed project. In response to said Motion, the Commission, by Order entered August 30, 1985, established the instant case with the record of Case No. 9212 incorporated herein by reference.

The amended project financing totaling \$372,400 includes \$41,400 from applicants for service in the proposed project area and the Reserve Account, a \$228,000 grant from the Farmers Home Administration ("FmHA") and a \$103,000 loan from the FmHA at 7 1/4 percent annual interest. Levee Road will enter into a security agreement with FmHA for the loan. The repayment period for the loan will be 40 years.

The proposed construction will provide service to about 101 applicants for service. Plans and specifications for this construction as prepared by Leake and Associates, of Mt. Sterling, Kentucky, ("Engineer") have been approved by the Division of Water of the Natural Resources and Environmental Protection Cabinet. A hearing was held in the offices of the Public Service Commission, Frankfort, Kentucky, on September 25, 1985. There were no intervenors present and no protests were entered.

Levee Road requested rates which would produce an annual increase of \$10,980. In this Order, the Commission has allowed rates which will produce an annual increase of \$7,099.

COMMENTARY

Levee Road is a non-profit water utility engaged in the distribution and sale of water to approximately 254 customers in southeastern Montgomery County, Kentucky. There are two other non-profit water utilities providing water service in Montgomery County adjacent to Levee Road's service area. The Reid Village Water District serves approximately 550 customers in the vicinity of the community of Reid Village in western Montgomery County. The Montgomery County Water District No. 1 provides water service to approximately 360 customers in the vicinity of the community of Camargo in south central Montgomery County.

KRS 74.361 states in part:

The general assembly of the Commonwealth of Kentucky determines as a legislative finding of fact that reduction of the number of operating water districts in the Commonwealth will be in the public interest, in

that mergers of such districts will tend to eliminate wasteful duplication of costs and efforts, result in a sounder and more businesslike degree of management and ultimately result in greater economies, less cost, and a higher degree of service to the general public; and that the public policy favors the merger of water districts wherever feasible.

Mr. Harold W. Witt, President of Levee Road, testified that the water association has not investigated the possibility of merging with either of the water systems near it in Montgomery County. In view of the legislative mandate, the Commission is of the opinion that Levee Road should seriously consider merging with the non-profit water systems in Montgomery County.

CONTINUITY OF ADEQUATE AND RELIABLE SERVICE

Levee Road's Engineer has provided information and testimony which appear to indicate that reliable and adequate service can be maintained throughout the expanded system after completion of the proposed construction. The Commission is concerned, however, that Levee Road's service to its customers in the higher elevations of its service area may not be totally adequate in the long term.

The Commission reminds Levee Road of its obligation to provide adequate and reliable service to all of its customers. Levee Road should monitor the adequacy of the expanded water distribution system after construction. If this monitoring indicates that the level of service is inadequate or declining, Levee Road must take necessary actions to maintain the level of service in conformance with the regulations of this Commission.

TEST PERIOD

For the purpose of determining the reasonableness of the proposed rates, the 12-month period ending December 31, 1984, has been accepted as the test period.

REVENUES AND EXPENSES

Levee Road showed a net loss on its books for the test period of \$6,667. Levee Road proposed several pro forma adjustments to its test period operating revenues and expenses to more accurately reflect current operating conditions. The Commission finds these adjustments reasonable and has accepted them for rate-making purposes with the following exceptions:

Operating Revenues

Levee Road showed operating revenue of \$41,703 received from its 251 customers during the test period. As a result of the proposed construction, as set out in the application of Levee Road, there will be approximately 101 new customers in the extended area which will produce an additional \$18,506 based on its present rates. This results in total operating revenues of \$60,209.

Purchased Water Expense

During the test period, Levee Road incurred water expense of \$17,566. In response to this Commission's request for information dated April 30, 1985, Levee Road furnished a breakdown of water purchases and sales for the test period which indicated an abnormally high loss of water during the test period due to major breaks in the distribution lines. This results in water

loss of 25.8¹ percent. The Commission has an established precedent for rate-making purposes of disallowing the cost associated with water loss in excess of 15 percent. Therefore, using the current rate charged by Levee Road's supplier, the City of Mt. Sterling, the Commission has determined that the appropriate adjusted purchased water expense for rate-making purposes is \$21,630,² or \$1,311 less than the level projected by Levee Road.

Salaries and Directors' Fees

During the test period, Levee Road paid salaries and directors' fees totalling \$8,401. In its response to the Commission's request for additional information, it provided an analysis indicating the amount each employee and director received during the year. Further review of the information indicated that a Christmas bonus of \$200 was paid to each of the two employees and \$150 to each of the five directors, for a total of \$1,150. During cross-examination, Mr. Harold W. Witt, President of Levee

¹ 24,124,868 gallons purchased less 17,902,858 gallons sold = 6,222,010 ÷ 24,124,868 = 25.8%.

² Computation of Allowable Purchased Water Expense:

Cost per 1000 gallons purchased: \$17,666 ÷ 24,124,868 = \$.7323 per 1000 gallons

Gallons sold during the test period	17,902,858
Gallons to be sold to 101 new customers	7,203,939
Total gallons	<u>25,106,797</u>
	• .85
Allowable gallons	<u>29,537,408</u>
Cost per gallon	X .7323
Allowable purchased water expense	<u>\$ 21,630</u>

Road, stated that these bonuses were free gratis and in lieu of compensation for time spent on the new extension.³ The Commission is cognizant of Levee Road's position, but it is of the opinion that bonuses are discretionary and in this instance are non-recurring. Therefore, the expense of these bonuses has been denied and test period operating expense reduced by \$1,150.

Public Service Commission Assessment

Levee Road failed to pay this Commission's 1984 assessment of \$50 as indicated by a letter dated November 1, 1984, from the Secretary, Mr. Forest M. Skaggs, advising them of the delinquency. However, the payment was made in 1985 and the Commission has allowed the expense to be included in 1984 test period operating expenses.

Therefore, Levee Road's adjusted operations at the end of the test period are as follows:

	<u>Levee Road Adjusted</u>	<u>Commission Adjustments</u>	<u>Commission Adjusted</u>
Operating Revenues	\$ 60,209	\$	\$ 60,209
Operating Expenses	50,934	(2,411)	48,523
Net Operating Income	\$ 9,275	\$ 2,411	\$ 11,686
Interest Income	1,734		1,734
Interest Expense	14,233		14,233
Net Income	<u>\$ (3,224)</u>	<u>\$ 2,411</u>	<u>\$ (813)</u>

REVENUE REQUIREMENTS

The Commission has used the debt service coverage method to determine appropriate revenue requirements for Levee Road. Levee

³ Transcript of Evidence, September 25, 1985, page 8.

Road's average debt service for the next 5 years is approximately \$17,099 based on existing debt service of \$9,070 and coverage on proposed debt of \$9,029. Levee Road's adjusted operating income of \$11,686 plus other income of \$1,734 provides a debt service coverage ("DSC") of approximately 0.78X. The Commission is of the opinion that this coverage is unfair, unjust and unreasonable. The Commission is also of the opinion that the allowed increase in rates of \$7,099 when combined with net operating income of \$11,886 and other income of \$1,734 will produce a DSC of 1.2X which is the coverage necessary for Levee Road to pay its operating expenses, to meet the requirements of its lenders and ensure the financial stability of Levee Road.

TAP FEES

Levee Road's present tap fee for a 5/8-inch X 3/4-inch connection and a 1-inch connection is \$350. Levee Road proposed to increase its tap fee to \$455 and filed cost data justifying the increased costs. The Commission is of the opinion that the proposed tap fee is reasonable and should be approved.

FINDINGS AND ORDERS

The Commission, after consideration of the application and evidence of record and being advised, is of the opinion and finds that:

1. Public convenience and necessity require that the construction proposed in the application and record be performed and that a certificate of public convenience and necessity be granted.

2. The proposed project for the Levee Road water system includes a 75,000-gallon water storage tank, 101 service connections, about 12.4 miles of 6-, 4- and 3-inch water main and miscellaneous appurtenances.

3. The low bids received for the proposed construction totaled \$291,034 which will require about \$372,400 in project funding after allowances are made for fees, contingencies and other indirect costs.

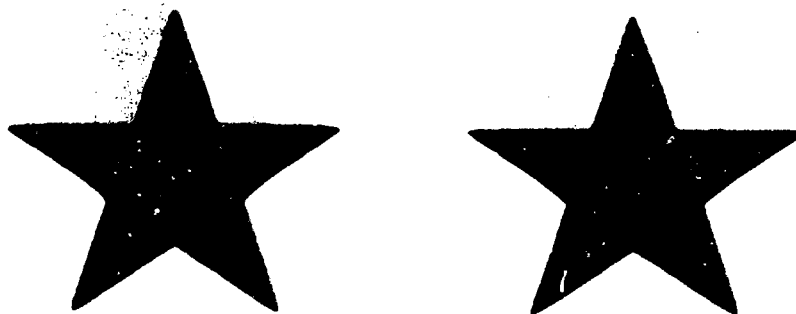
4. Any deviations from the construction herein approved which could adversely affect service to any customer should be subject to the prior approval of this Commission.

5. Levee Road should obtain approval from the Commission prior to performing any additional construction not expressly certificated by this Order.

6. Levee Road should file with the Commission duly verified documentation which shows the total costs of construction including all capitalized costs (engineering, legal, administrative, etc.) within 60 days of the date that construction is substantially completed. The construction costs should be classified into appropriate plant accounts in accordance with the Uniform System of Accounts for Water Utilities prescribed by this Commission.

7. Levee Road's contract with its Engineer should require the provision of construction inspection under the general supervision of a professional engineer with a Kentucky registration in civil or mechanical engineering. The supervision and inspection

CORRECTION



***PRECEDING IMAGE HAS BEEN
REFILMED
TO ASSURE LEGIBILITY OR TO
CORRECT A POSSIBLE ERROR***

2. The proposed project for the Levee Road water system includes a 75,000-gallon water storage tank, 101 service connections, about 12.4 miles of 6-, 4- and 3-inch water main and miscellaneous appurtenances.

3. The low bids received for the proposed construction totaled \$291,034 which will require about \$372,400 in project funding after allowances are made for fees, contingencies and other indirect costs.

4. Any deviations from the construction herein approved which could adversely affect service to any customer should be subject to the prior approval of this Commission.

5. Levee Road should obtain approval from the Commission prior to performing any additional construction not expressly certificated by this Order.

6. Levee Road should file with the Commission duly verified documentation which shows the total costs of construction including all capitalized costs (engineering, legal, administrative, etc.) within 60 days of the date that construction is substantially completed. The construction costs should be classified into appropriate plant accounts in accordance with the Uniform System of Accounts for Water Utilities prescribed by this Commission.

7. Levee Road's contract with its Engineer should require the provision of construction inspection under the general supervision of a professional engineer with a Kentucky registration in civil or mechanical engineering. The supervision and inspection

should insure that the construction work is done in accordance with the contract plans and specifications and in conformance with the best practices of the construction trades involved in the project.

8. Levee Road should require the Engineer to furnish a copy of the record plans and a signed statement that the construction has been satisfactorily completed in accordance with the contract plans and specifications within 60 days of the date of substantial completion of this construction.

9. A 5/8-inch x 3/4-inch meter should be the standard customer service meter for all new customers and should be installed at all points of service unless the customer provides sufficient justification for the installation of a larger meter.

10. Levee Road should file with the Commission a copy of all contractual agreements for the provision of services or the purchase of services which are subject to the approval of this Commission.

11. The proposed borrowing of \$103,000 is for lawful objects within the corporate purposes of Levee Road, is necessary and appropriate for and consistent with the proper performance of services to the public by Levee Road, and will not impair its ability to perform these services.

12. The financing secured by Levee Road for this project will be needed to pay for the work herein approved. Levee Road's financing plan should, therefore, be approved.

13. Levee Road should investigate the feasibility of merging with the Reid Village Water District and the Montgomery County District No. 1. Levee Road should file a written report on the results of its investigation with the Commission within 90 days of the date of this Order.

14. The tap fee proposed by Levee Road is reasonable and should be approved.

15. The rates proposed by Levee Road produce revenues in excess of the revenues found reasonable herein and should be denied upon application of KRS 278.030.

16. The rates in Appendix A are the fair, just and reasonable rates to charge for water service rendered to Levee Road's customers and should produce annual revenues of approximately \$67,308.

IT IS THEREFORE ORDERED that Levee Road be and it hereby is granted a certificate of public convenience and necessity to proceed with the waterworks construction projects described by the plans and specifications of record hereby approved.

IT IS FURTHER ORDERED that Levee Road shall comply with Findings 4 through 10, 12 and 13 as if the same were individually so ordered.

IT IS FURTHER ORDERED that the rates proposed by Levee Road be and they hereby are denied.

IT IS FURTHER ORDERED that the tap fee proposed by Levee Road and shown in Appendix A be and it hereby is approved.


IT IS FURTHER ORDERED that the rates in Appendix A be and they hereby are approved as the fair, just and reasonable rates to be charged by Levee Road for water service rendered on and after the date of this Order.


IT IS FURTHER ORDERED that, within 30 days of the date of this Order, Levee Road shall file with this Commission its tariff sheets setting forth the rates approved herein and a copy of its rules and regulations for providing water service.

Nothing contained herein shall be deemed a warranty of the Commonwealth of Kentucky, or any agency thereof, of the financing herein authorized.

Done at Frankfort, Kentucky, this 11th day of October, 1985.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 9410 DATED 10/11/85

The following rates and charges are prescribed for the customers in the area served by Levee Road Water Association, Inc. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the effective date of this Order.

RATES: Monthly

First 1,000 gallons	\$6.80 Minimum Bill
Next 2,000 gallons	2.45 per 1,000 gallons
Next 3,000 gallons	1.95 per 1,000 gallons
Next 19,000 gallons	1.45 per 1,000 gallons
Next 25,000 gallons	1.20 per 1,000 gallons
Over 50,000 gallons	1.00 per 1,000 gallons

Connection Fee

5/8 x 3/4-Inch	\$455
1-Inch	455